Transcription for ŞIŞECAM A.Ş

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Presentation

Operator
Ladies and gentlemen, welcome to Şişecam 2017 Yearend Consolidated Financial Results conference call. I will now hand over to Mr Görkem Elverici, CFO. Sir, please go ahead.

Görkem Elverici
Good afternoon ladies and gentlemen. I would like to welcome you to our webcast today where we will be talking about our year-end results and key developments that have had impacts on our operations.

[Introductions and disclaimer]

Before talking about financial performance in 2017, I would like to walk you through the economic and political landscape, as well as industrial developments very briefly that has significant impact on our operation.

Moving onto page two, IMF upgraded its global economic growth forecast by 0.2 percentage points to 3.9% for both 2018 and 2019 on the back of a better outlook in the U.S. and Eurozone. In the second half of 2017, U.S. continued to grow strongly while employment market remains solid leading to further improving sentiment about the macroeconomic outlook. New tax reform encouraging the business environment for new investments with the retained funds as a result of corporate tax rate cuts, paved the way for additional growth momentum. In December, Fed increased its benchmark interest rate by a quarter point to 1.5% as the third time in 2017. Fed officials cut their estimates for the unemployment rate to 3.9%, while they increased the inflation forecast by 10 bps to 1.7% in 2018. The IMF raised its growth forecast by 40 bps to 2.7% for 2018 and by 60 bps to 2.5% for 2019.

Business sentiment and consumer confidence thanks to robust macroeconomic indicators signalling self-sustaining recovery across the Eurozone continued. Strong economic growth in the Eurozone has reflected to the currency valuation with Euro/Dollar parity rising to its three-year high level in January 2018. Even though a debate on ending the bond buyout programme has started, ECB downsized the programme by half and confirmed that the monetary easing will be maintained until September 2018 by reversing the right to boost it back if needed. The IMF lifted its Euro area growth forecasts by 30 bps in both 2018 and 2019 to 2.2% and 2% respectively.

Turkey had a brisk performance in the third quarter by recording a growth rate of 11.1% and bringing the nine-month economic growth up to 7.4%. Stimulus measures namely TRY 250 billion capital injection through credit guarantee funds, rate subsidies, cut in bank provisions and VAT on durable goods, flexible due dates for tax and social security payments and the low base effects were the triggers of the robust economic performance.

Similar to growth, Turkey has experienced a surge in inflation reaching to an annual pace of 11.9% in December. The IMF more than doubled its forecast for Turkey's economic growth in 2017 by increasing it to 5.1% and it declared its 2018 expectation at 3.5% based on the predictions that the growth will slow down due to decreasing financial aid and tight monetary policy.

I would like to talk about industries that are relevant to our operations on page three.

I would like to give a brief update of the global glass industry and Turkish glass industry. Globally, a growth of 4-5% per annum is sustained, while Turkey has a total production capacity of around 4 million tons, where almost 78% belongs to Şişecam. In 2017, Turkey's glass exports volume increased by 10% year-on-year, thanks to increase in flat glass exports, while glass imports was increased only by 2%, as a result of increase in import tariffs on glassware products.

Construction industry grew by 10% in the nine months as Government incentives towards the industry led the market growth. Exports in automotive industry grew by 17% while production increased by 14% in 2017. We have also seen white goods sales increasing and recording an annual growth of 9% in production terms. As for tourism, Turkey's revenues grew by 19% year-on-year growth as the number of tourists increased by 23%.

Before moving onto the financial results, I would like to talk about developments that took place in our group in 2017 on page four.

A new fibreglass investment has been initiated by Soda Sanayii and TRY 330 million investment incentive was granted within the second half of 2017. As a move to further increase the group's transparency through the elimination of cross-ownerships, we sold our minority stakes in Anadolu Cam Yenişehir and Eskisehir plants to Anadolu Cam. Şişecam wholly owned Trakya Yatırım Holding and sold its stake in Topkapı Yatırım Holding and we sold our 5% stake in Oxyvit to Soda Sanayii. As part of our strategy in focusing fully on core business areas, we sold our 50% stake in molds supplier company, OMCO Kalıp for TRY 32 million. We also transferred shares of our Eskisehir corrugated packaging plant of Camis Ambalaj conducting its operations under glassware segment to an affiliate of Austria-based packaging company. In the glassware segment, in order to optimise Turkey's production capacity, we terminated the operations of one of the furnaces located in Kırklareli plant and took over the assets of Egyptian glassware producer, Pearl within the year. In glass packaging, cold repair in Anadolu Cam's Ufa plant A furnace and Mersin plant were completed within the first half of the year. C furnace located in Ufa plant went through a cold repair process until the fourth quarter of 2017. We announced a furnace investment of 150,000 tons per year in Eskişehir. In flat glass, Competition Board imposed TRY 17 million administrative fine which had negligible impact on Trakya Cam financials. As a result of investigation against flat glass imports from Russia, 8-10% anti-dumping tax per ton was imposed for five years. After the reporting period, we have announced an investment for an additional float line in Polatlı to meet the growing demand across Turkey and surrounding regions, which will become operational most probably in 2020. We have bidded for some Sangalli Manfredonia in Italy and the bidding process still continues. We also started negotiations to acquire 50% stake in HNG, our Indian joint venture. Botas natural gas distributor announced 13.6% hike in tariffs in the beginning of this year and yet we remain focused on executing our energy efficiency controls.

We can now move on to the financial and operational overview section.

Let's have a look at our financial performance in 2017 compared to last year.

On slide five, our company posted strong results in 2017, as top line growth came in at 32%, which is significantly above the last five years average of 12%, as a result of very significant contribution of our divisions. We have restated top line figures of the company for 2016 and 2017 figures due to change in the accounting of third party logistics treatment. On the profitability side excluding one-offs, EBITDA margin reached 25%. EBITDA figure grew by 46% year-on-year. On the bottom line, again when adjusted for one-offs, 59% increase in net income after non-controlling interest mostly reflects higher operating profits recorded by the divisions. Almost TRY 840 million free cash flow was generated in 2017 as a result of effectively managed working capital requirements and lower CapEx in the year. CapEx to sales ratio decreased to 9% level.

On slide six, we can see the historic evolution of our top line growth; steadily increasing and EBITDA margin levels that were kept at or above sustainable level of 20% in line with our strategy thanks to robust operational performance across all divisions.

Moving onto page seven, highest contribution to Şişecam top line is from flat glass business reflecting positive contribution of Italian operations and price hikes made throughout the year. We have witnessed strong top line growth in glass packaging and chemicals divisions too, owing to good pricing in glass packaging and solid volumes in chemicals combined with favourable currency markets. Increase in hard currency denominated sales also supported glassware division's top line, as international revenues' share increased to 63% in 2017 from 58% last year.

On slide eight, flat glass segment's EBITDA contribution has also increased significantly from 33% to 39%, while glass packaging segment's share moved up to 19% thanks to improvement in capacity utilisation rates, recovery in demand conditions and price tariffs implemented in 2017. Chemicals' contribution dropped to 29% from 34% while EBITDA margin of the division was up from 27% to 30% year-on-year. Glassware's contribution decreased from 13% to 10% of which EBITDA margin increased from 14% to 15% year-on-year.

On slide nine, I would like to talk about our free cash flow generation. As I mentioned on the previous slides, almost TRY 840 million free cash flow was generated in 2017 compared to last year's negative figure, mainly thanks to increase in operational cash flow as a result of material increases in net income and effectively managed working capital requirements.

Turning to the next slide, CapEx recorded at around TRY 1 billion including advances paid related to capital expenditures. After a heavy investment cycle, as promised, we managed to decrease our CapEx to sale ratio during the digestion period, which came in at a very radical 9% in 2017. We will be continuously focusing on operational excellence efforts going forward.

On the next slide, we continue with our CapEx funding analysis. As you know, Şişecam is not a highly leveraged company despite the robust investments undertaken historically. In 2017, thanks to the continuous strong EBITDA generation and decrease in CapEx levels, EBITDA to CapEx ratio came in at 3%, which is well above our historic average.

On page 12, we can see the evolution of the production in the course of the years. In 2017, 5% growth in glass production was realised mainly with the capacity inclusion of one float line in Italy after the acquisition of Sangalli assets. In line with the improved capacity utilisation rates and boosted exports, production volumes in glass packaging increased year-on-year basis, albeit glassware production was curbed due to the slowdown in the market that led us to focus on capacity optimisation plan.

On Soda side, improved capacity utilisation levels resulted in 3% growth in production. Starting from last year's second quarter, capacity increased was made in Mersin by 80,000 tons in 2016. Please note that in glass, while 58% of the production is realised in Turkey, remaining 42% is produced in the plants outside of Turkey. In soda ash, 59% of the production is realised in Turkey and the remaining 41% is produced in the plants outside of Turkey.

On page 13, you will see debt profile of Şişecam in terms of interest rates, maturity, and currency structure. Our gross debt in hard currency is 80% of total. While 33% of the loan book including the 2020 Eurobond has a maturity of less than one year, the rest is mostly in maturing in one to five year's timeline. As for the interest rate structure, the portion of fixed rate liabilities has increased from 59% to 63%.

On page 14, looking at the ratios, we continued to sustain the low and conservative net debt to EBITDA and net debt to equity levels of 0.2 and 0.04 respectively, which are both the lowest of the past five years. Still, we have huge headroom in terms of covenants in our loan agreements and Eurobond. We believe these levels are sustainable.

Moving onto the next slide, we are seeing that Şişecam's strong cash performance continued in this period as well. More than 73% of all cash in hand is in hard currencies, together with $500 million Eurobond investments. In September 2016, we started investing in U.S. dollar denominated Eurobonds with an average yield of around 5.5%, as we are hedging interest rates on our outstanding Eurobond and there is a positive carry that we benefit from. As mentioned in our previous calls, this strong cash position gives us the flexibility of proceeding fast in case of viable M&A opportunities, while we also continuously seek better ways to optimise our already strong balance sheet management.

Moving onto the next slide, you can see that we continue to have a long FX position at the consolidated level. Our long position in dollar and short position in euros also continued in this period. I would like to remind you that we do not use any derivatives other than some very limited interest rate swaps and cross-currency swaps for hedging purposes. We will continue to use the hedging transactions as needed, but our enlarged operations and geographies are also providing opportunities to utilising hedging within our own balance sheet.

Now, I would like to walk you through each division in this last section of our presentation.

Starting with flat glass, 2017 has once again been a year of solid results for Trakya Cam, which recorded 44% year-on-year top line growth and its revenue reached to TRY 4.3 billion. Excluding Italy, which was taken over at the end of 2016, we still have a 34% year-on-year growth in revenues thanks to the improved demand conditions and pricing environment in all operating regions. 34% year-on-year growth was mainly driven by a 12% increase in total volume and change in production, 8% increase in price on average and 14% coming from positive currency impact. For the full year, our adjusted EBITDA margin was 25% compared to 21% in 2016 as a consequence of price hikes made in flat glass throughout the year. Boosted sales in auto glass with a growing margin and positive price effects coming from increased sales of value-added glasses. In Turkey, 40% year-on-year rise in sales has been stimulated by strong volume growth and positive price effect through the hikes implemented in 2017, a total of 19%. Total domestic demand for flat glass grew by 13% in 2017, reflecting strong demand in construction and widespread use of value-added glasses. Industry growth patterns indicate that the demand for value-added glass will escalate going forward, as a result of increasing flat glass need. We will add a new float line in Turkey with the purpose of enhancing our production capacity in order to meet this diversifying demand. New line will become online most probably in 2020. Our production capacity in Europe increased to approximately 700,000 tons in 2017, after consolidation of Italy, which led Trakya Cam to have a higher penetration in potential markets. Upward trend in energy prices compared to prior year was balanced with the price hike introduced in the market as we maintained our profit levels while keeping pace with expected demand.

Profitability of Bulgarian and Italian plants were in line with the consolidated level, whilst Romanian auto glass unit turned into a profitable business in 2017, owing to improved utilisation in its high technical capacity. Our encapsulation business generated over €170 million in 2017, mainly driven by volume growth and Euro appreciation against Turkish Lira by 23% on average. In Russia, domestic consumption for flat glass remained constant in 2017, however, Trakya Cam increased its market penetration, which lifted the sales up in the region, increase in average sales prices, and appreciation of Russian Rouble against Turkish Lira also supported the region's profitability. In 2017, CapEx was recorded over $70 million including our coated glass investment in Turkey, energy efficiency investments in Turkey

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and Italy and small sized line investments in Bulgaria and Romania. $6 million CapEx made for the cold repair in Bulgaria, which is planned to start in August 2018. As our focus on regional opportunities continues, we have bidded for the line in Manfredonia in Italy and started negotiations with Hindustani National Glass to acquire a 50% share in our joint venture in India.

Moving into glassware segment, 8% year-on-year top line growth was recorded in 2017, with a 15% EBITDA margin. Excluding the one-off impacts, EBITDA margin stood at 14% as flat. Our subsidiary, Camis Ambalaj corrugated cardboard packaging producer under glassware division, was sold in the beginning of this year. Like for like growth in top line would have been 15% in Turkish Lira if there were no revenues generated by that business 2017 either. Our gross profit margin increased to 34% in 2017 compared to the prior year's level of 31%. Excluding the sale of corrugated packaging, gross profit margin would still be improving on a year-on-year basis as a consequence of the decrease in marginal costs. Initiatives taken throughout the year to optimise capacity and better product mix scaled down the cost and enabled us to deliver margins better than the ones recorded in 2016. After the closure of Mersin facility at the end of 2016, we terminated the operations of one of the four furnaces in Kırklareli plant within the second quarter and in turn our utilisation rate went up in Turkey. Our glassware unit also increased its domestic market share while in the meantime and additional 23% customs tariff prevented cheap imported products to dilute the domestic market. Share of international sales rose to 63% in 2017, as competitive trends remained challenging throughout the year, especially in Europe. Revenue contribution of Russian operations was 10% while strong gross margin recorded in the region led to an improvement in production efficiency. Our efforts to penetrate to the potential markets continues without compromising for profitability as the strategy is focused on evolving the product portfolio into a more standard form by increasing the share of higher margin products. As I mentioned previously, the took over Pearl's assets, the Egyptian glassware producer, will play a key role or us to penetrate to the potential markets. Our intention to list Paşabahçe continues and if market conditions for both glassware industry as well as the equity capital markets are favourable, we aim to find the right window of opportunity, most probably starting from next year.

Moving onto glass packaging, we had a top line growth of 32% year-on-year. With Anadolu Cam's record high revenues, 2017 year-end revenues exceeded TRY 2.4 billion. Average unit price increased in Russia by 9% in Rouble terms and Turkey by 8% coupled with 6% sales volume growth on a consolidated basis and appreciation of Roubles against Turkish Lira of 38% based on year-on-year average rate for the reasons behind our superb top line performance. With 10% rise in domestic sales and 5% higher sales volumes recorded by international operations, including the exports from Turkey on top of translation gains, we managed to have a revenue portfolio equally composed of domestic and international sales. Growing demand for glass packaging was the trigger for domestic sales growth, but the sales performance has been stimulated by brought forward orders during price increase negotiations for both 2017 and 2018 as well. Anadolu Cam maintained its cost-effective structure with its capacity utilisation rate of 97% in Turkey and beyond 90% in Russia. Thanks to a top line growth rate higher than the relevant cost of goods sold stemming from the higher level of value added sales mix, our COGS to sales ratio came down by 280 bps to 72%. OpEx to sales ratio improved by 200 bps on a year-on-year basis to 18% as a result of a mere 17% rise in operational expenses versus the top line growth mainly as a result of the decline in severance payments provision, and in outsourced expenses. Consequently, Anadolu Cam recorded a 23% adjusted EBITDA margin. In the second half of 2017, C furnace located in Ufa Plant underwent a cold repair process as planned. On top of the TRY 182 million worth of CapEx made in the first six months of 2017, the company has another TRY 156 million CapEx in relation with cost repairs schedule and mold, efficiency and maintenance investments. Anadolu Cam announced its decision to invest in a forth furnace with 150,000 tons per year production capacity in its Eskisehir plant for total CapEx of $66 million, including working capital requirement. For this capacity addition project, that is planned to be operational in the second half of this year, Anadolu Cam spent $9 million already in the last quarter of 2017. We continue to be the largest glass packaging producer in our operating regions. We managed to increase our Russian market share to 30% in a period in which glass packaging demand was flat. We moved another step away from our domestic competitors in order to meet our plans of growing in parallel to the rising glass packaging market by investing in the local capacities.

As part of our strategy making the corporate structure more linear, we completed the merger of Eskisehir and Eskisehir plants under Anadolu Cam Sanayii.

Moving onto the chemicals division, our chemicals division continued to perform very strongly. While the top line grew by 19% year-on-year, we have managed to keep our EBITDA margin adjusted to one-off gains flat at 30% in a weaker price environment in both segments compared to last year globally. Factors leading to the top line growth were sales increase of 2% in soda ash and 10% in chromium segment. While the average soda ash unit price decreased by 3% on a year-on-year basis, and the chromium chemicals prices were flat in the meantime, our revenues were positively affected by the depreciation of Turkish Lira against hard currencies, mainly by 21% against Dollar and by 23% against Euro on average. Following Şişecam glass companies' decision to procure a portion of their local soda needs from local natural soda producer by the beginning of 2017 and onwards, we started to channel a higher volume of our production to international markets. In turn, share of non-group sales in our revenue portfolio increased to 84% versus 70% levels previously. Throughout the year, Soda Sanayii recorded TRY 133 million CapEx for the glass fibre, operational efficiency, and modernisation investment.

Following the introduction of our new boiler configuration at the very end 2016, we are now able to produce steam with a limited vulnerability to natural gas. This new system in which utilisation rate to the co-generation facility was cut by almost half and the remaining steam need has been produced through the coal-fired boiler, led to savings in soda ash production costs and in return it enabled us to offset negative impact of the surge in chromite and anthracite prices. As a higher percentage of cost of goods sold are in Turkish Lira compared to revenues, which are 36% against 16%, devaluation has also had a positive impact on the gross profit. As for the end-markets for soda products, the demand continued to be strong in the region, fuelled by the economic growth in the emerging markets that especially supporting construction and automotive industries. Soda ash pricing environment on the other hand has been depressed since the last quarter of 2016 with the expectation of intensifying competition. Introduction of our local competitor's long awaited second mine with approximately 2.5 million tons annual production capacity into the market last September, pricing environment will remain the same for another year or so, until the new capacity to be fully absorbed by the demand globally.

In the chromium chemicals segment on the contrary we have been witnessing an improving pricing environment with the decision of Lanxess to close down its 65,000 ton BCS and 45,000 tons sodium dichromate production capacities located in Argentina.

In the third quarter of 2017, Soda Sanayii became the sole owner of Oxyvit through the acquisition of a majority shareholder Cheminvest and Şişecam's 5% stake in the company. Since then, Oxyvit has been fully consolidated and its financial results are being reported under the chromium chemicals segment. Even though the company's turnover is minor compared to the overall size of Soda Sanayii with its 50% profitability, Oxyvit had a positive impact on our financials.

Soda Sanayii's glass fibre investment, which is expected to be operational in the second half of 2018, progresses as planned.

Coming to the end of the presentation before jumping to the key takeaways, I would like to remind you that our board of directors decided to distribute TRY 300 million gross dividend, which will be submitted to the general assembly probably on 21th March. For key takeaways, we have increased our top line and profitability levels as well as recording strong cash position and conservative leverage in 2017. We have a continuous focus on operational excellence leading to smart cost management. We have above industry levels profitability compared to our global peers and we have a continuous focus on M&A opportunities on a selective basis.

Coming to the end of our presentation. I will be happy to take your questions.

Question and Answer Session

Operator

Our first question comes from Omer Omerbas, AK Yatirim. Please go ahead.

Omer Omerbas

I have two questions, please. First, can you share some more information on the operational profitability of Fritz Holding, how does the EBITDA margin stand currently when compared to Trakya Cam's consolidated EBITDA margin, and what do you expect going forward? For the second question on Anadolu Cam, so obviously you have recorded the best EBITDA margin performance in the past five to six years if I am correct and how do you see the outlook going forward? How much room on the upside do you see here and what will be the sustainable level of the EBITDA margin for Anadolu Cam in the next, say, two to three years? Thank you very much.

Görkem Elverici

Thank you, Omer. Starting with Fritz you know that Fritz has been acquired from a private equity and the business was on hold for almost one and a half to two years before we acquired. So considering the realities of the auto glass business, being on hold means that you are missing some of the projects that will become in the pipeline maybe a couple of years later. So after the acquisition, although there was almost around €140 million of existing business, when you look at the outlook moving forward for the next five years of Fritz, there was a foreseen decrease in the overall business volume of Fritz. So, the company has started negotiations mainly with the German auto OEMs, but also with the other ones, and combined the capabilities of Trakya Cam auto glass plus Fritz's encapsulation capacities. So due to the submitting projects in the portfolio and some lower margin projects I should say that were a part of the business in the first years, I should say starting from 2015 until 2017, the performance was a little bit lower than our regular auto glass businesses elsewhere. So if projects has been added to the portfolio, the necessary operational excellence programmes have been run for the last three years and especially the improvements in the productivity and higher value added products added to the project's portfolio are helping Fritz to better manage its turnaround and come up with better results. I should say that on EBIT and EBITDA levels we are still comparable to the existing auto glass businesses of Trakya Cam, but a little bit lower, but our expectation is starting from 2018 they will very soon come close to the average levels we have elsewhere.

Coming to the second point, looking at the fundamentals of the businesses in both Turkey and Russia, when we look at the outlook, there does not seem to be too many negative surprises on the way, at least for 2018, unless a catastrophic thing happens that no one can foresee from now. But the operational excellence programmes that have been around for the last three years improved capacity utilisation rates and improved cost to sales ratios, are helping both Turkish and Russian operations to generate better margins. And also increased focus to export businesses, especially in Turkey, is helping us to better manage the risks and come up with some additional margins when we find the opportunities. So we believe that at least the level of margin contributions should continue, if not getting better.

Operator
Our next question comes from Akif Dasaran, TEB Investment. Please go ahead.

Akif Dasaran
Can you please elaborate on your expectations on your energy costs for 2018, including electricity prices and natural gas prices? Thank you.

Görkem Elverici
So I believe looking at the expectation of the market analysis for both of these industries will be better, because we are also following the guidances provided by them, and that the natural gas prices are only published for the next month and electricity prices almost for a quarter. We have already seen important increases in both of the industries and that may continue. But we believe that the most important thing for the competitiveness and the performance of all the companies under Şişecam whether we are able to translate it into our sales price or not, and I believe that until now we have always shown that we have been able to translate it to our sales prices. And even we have done it in advance in most of the segments, as we believed

that there was a coming increase in the natural gas prices and electricity prices when you look at the historical trend. So the thing is that looking at the market analysis expectations and the historical trends, it seems that there might be additional hikes that might happen in 2018, but I believe that almost all the companies are prepared for upcoming price hikes in the energy segment.

[No further questions]

Görkem Elverici
Ladies and gentlemen, we would like to thank again for your participation and just to remind you that we will be happy to host you for the first half-year results of 2018, and hope to meet you soon. Thank you.
